

June 27, 2005

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, Second Floor
Boston, Massachusetts 02110

Re: Annual Report on the NSTAR Electric 2005 Energy Efficiency Plan; D.T.E. 05-31

Dear Secretary Cottrell:

Pursuant to 225 CMR 11.04(6), the Division of Energy Resources (DOER) is required to file a report with the Department of Telecommunications and Energy (DTE) as to the consistency of investor owned electric company energy efficiency plans with the energy efficiency goals of the Commonwealth. In addition, pursuant to G.L. c.25A, § 11G (inserted by the 1997 Electric Industry Restructuring Act), the Division is required to annually file a report with the DTE on proposed funding levels for investor-owned electric energy efficiency programs mandated by G.L. c.25, § 19. This letter constitutes the fulfillment of these regulatory and statutory obligations regarding the energy efficiency plan and budget proposed by the NSTAR Electric Company for the year 2005.

Authority:

Pursuant to the aforementioned authority, the DTE and the DOER share responsibility for regulating investor-owned electric energy efficiency programs. With respect to the Division's responsibilities the Act directs the DOER to oversee and coordinate ratepayer-funded energy efficiency programs. Furthermore, the DOER is charged with achieving certain goals, including:

- ensuring that energy efficiency funds are allocated equitably among customer classes;

- ensuring that there will be adequate support for “lost opportunity” efficiency programs in areas such as new construction, remodeling, and replacement of worn-out equipment;
- giving due emphasis to statewide market transformation programs in order to systematically eliminate market barriers to energy efficiency goods and services; and
- providing weatherization and efficiency services to low-income customers.

In compliance with our statutory mandate, the DOER submits this Annual Report with the DTE on the proposed funding levels for energy efficiency programs.

Process:

Six years ago, the DOER developed a set of statewide energy efficiency goals and objectives to guide its oversight of Massachusetts' electric ratepayer-funded energy efficiency activities. In 1997, the DOER developed these goals and objectives in consultation with industry and consumer stakeholders through a series of DOER-sponsored stakeholder workshops inviting extensive public comment over a period of six months. The DOER sought DTE staff participation in this process. Our publication of the goals and objectives provide guidance to energy efficiency Program Administrators (PAs) in designing their programs, and enable the DOER to review proposed energy efficiency plans for consistency with those goals and objectives. Furthermore, the DOER uses these goals to measure whether ratepayer funded programs are achieving the desired impact.

In large measure the Legislature itself declared the statewide energy efficiency goals for the Commonwealth. They announced them in key provisions of the Restructuring Act. These goals and objectives are consistent with general policy principles developed in the DTE's 96-100 energy efficiency plan guidelines and subsequent settlement agreements with distribution companies on their Energy Efficiency Plans.

During 2004, the DOER generated a software tool that we employed to assist the Program Administrators attain performance goals that maximizes energy savings for program participants and ratepayers, generally. We are pleased to report that our use of this tool has expanded net benefits for the energy efficiency ratepayer-funded programs. This tool helped the DOER achieve faster, deeper analysis of budgets and program elements. Though it did not accelerate review of Program Administrators' goals, the software enabled the DOER and the Non-Utility Parties to exert a more vigorous inquiry of Program Administrators' initial planned savings estimates. By applying the tool to successfully negotiate PAs' initial estimates upwards, the DOER realized an additional \$38 million in overall energy savings to ratepayers.

Findings:

Deleted: addition

Deleted: hall

Deleted: a

Deleted: ly file a

Deleted: r

Deleted: Each year the DOER's energy efficiency staff works with the company and other non-utility parties in translating the statewide energy efficiency goals into the Energy Efficiency Plan program design and budgets for the coming year. During 2004-2005, the DOER, the PAs, and advisors to the non-utility parties (the Group) have emphasized [FIND OUT FROM LARRY WHAT GOALS & ENHANCEMENT ON WHICH THE GROUP CHOSE TO FOCUS IN 2005 identifying enhancements of energy efficiency plan updates and the annual reporting process. We selected two (2) goals around which we would focus our efforts to improve the program: 1) increased transparency and 2) improved administrative efficiency. THE FOLLOWING 3 PARAGRAPHS ARE LIKELY OUT. CONFIRM WITH LARRY.]

To effect the first goal, the Group made changes that will more consistently account for program costs. First, the modified detailed accounts that support the program goals in the first section are readily linked as program costs and benefits throughout the plan. Second, in the budget section, PAs establish budgets for each customer sector based on projected collections for this program year, the appropriate methodology for funding its low-income programs, and a reconciliation of actual collections, budgets and expenditure for the prior year. As a result of our reforms, we have reorganized the layout of the three customer sector tables that provide budgets for each sector program. The organization of these programs in the budget section now enjoys an identical format with the tables in the Program Description section of the plan.

To advance greater transparency, we now create linkage between program costs and benefits associated with each program. The Group created and the PAs adopted a common designation for programs. We believe that the net effect of this collective action is greater than the sum of any individual actions these parties may have taken because this cooperation has created significant additional benefits to ratepayers. Multiple benefits accrue as we can now more readily discern economic

Deleted: I:\EEPlans-review\Final generic EEP apprvl ltr.3-9-04.doc

The DOER has reviewed the NSTAR Electric Company energy efficiency plan for year 2005. The Division finds that the Company's energy efficiency plan is consistent with the statewide energy efficiency goals. NSTAR Electric has proposed a plan submitted to the Department and the DOER on April 14, 2005 as described in the referenced plan in chapters II, III, IV, V and VI) and a budget (as detailed in II Budget and Appendix A: Benefit Cost Analysis) for the low income, residential, and commercial/industrial customers that adequately addresses the state's energy efficiency goals. Therefore, the Division of Energy Resources approves the plan for consistency with the energy efficiency goals of the Commonwealth.

Deleted: (

Deleted: attached

Deleted: Tables, 1, 2, 3 and 4

Deleted: [These need confirmation]

Potential Modifications and New Initiatives

While acknowledging the DTE's ultimate role in determining program cost-effectiveness, the DOER does include cost-effectiveness as an operational goal within its oversight and coordination role. Acknowledging that the programs in this 2005 plan are cost-effective, the DOER will supplement its Report by highlighting below certain program modifications and new initiatives that will affect future plans.

Residential Sector

Residential program managers are discussing significant modifications for two programs: Residential Heating Ventilation and Air Conditioning (HVAC) and ENERGY STAR® Appliances.

After January of 2006, when the federal efficiency standards for residential central air conditioning increase, the limited number of models that exceed the standard will not be sufficient for designing a program based on their savings. The Company is trying to determine whether training contractors to do a superior installation of central air conditioning will generate enough savings to make the program cost-effective.

In the ENERGY STAR® Appliances program, evaluation studies have suggested that ENERGY STAR® brand recognition and market penetration is so significant in the Commonwealth that the Company should consider lessening some of the incentives for this program in response to increasingly successful market transformation.

Low-Income Sector

Since 2004 the Low-Income Energy Affordability Network (LEAN, Network) has sponsored a best practices working group. The group is developing a protocol to insure state-of-the-art treatment of their clients' homes such that the Company may provide benefits linked to improved energy performance. This collective arrangement will expand the scope of customer services to include structural repair required for weatherization. These repairs may eliminate moisture problems that can result in mold-related health issues. Repairs also include sealing air leaks in such a way that the patch prevents vermin from entering the home.

LEAN also has a grant with the Renewable Energy Trust. Currently, LEAN is examining how to integrate renewable energy into the delivery of energy efficiency.

Deleted: I:\EEPlans-review\Final generic EEP apprvl ltr.3-9-04.doc

Simultaneously, LEAN is assessing advanced energy efficiency equipment. As we understand it, LEAN may use a portion of this grant money to ascertain the extent to which this equipment might become part of the Company's standard program offering.

Commercial & Industrial Sector

In the Commercial & Industrial sector two "Research & Development and Pilot" efforts have become elements to standard program offerings: demand response and Advance Building Guidelines (ABG).

In its demand response initiative, the Company educates appropriate customers about the ISO's demand response programs and helps the customers determine what kind of commitment they can make in the event that they decide to enroll in an ISO program. The DOER will follow the extent to which the Company can track the capacity benefits from this program element.

ABG is a prescriptive approach for incorporating an integrated design methodology to elevate energy efficiency in the construction of smaller commercial buildings. Generally speaking, these buildings are too small to justify the energy modeling that informs the design of larger commercial buildings. Energy modeling is the standard for quantifying savings for the Commercial & Industrial new construction program. The DOER will monitor the Company's progress in successfully recruiting developers and tracking savings within the ABG program element.

Performance Incentive for 200~~5~~:

In DOER's recommendation to the DTE regarding the 200~~4~~, NSTAR Electric Company energy efficiency plan, we commented at length (see DOER letter to Cottrell dated April 7, 2004; *Re: NSTAR Electric EE Plan; DTE 04-11*) why the Department should modify its performance incentive Guidelines with respect to the 200~~4~~ company performance incentive. For the 200~~5~~ plan, the DOER recommends that the Department again modify its performance incentive Guidelines and accept the incentive proposed by the Company. In support of this recommendation, the DOER provides the following information.

Background and rationale:

Prior to DTE 98-100 each utility's performance incentive was the result of periodic (typically annual) settlement negotiations among the parties participating in that utility's energy collaborative, subject to DTE approval. The result was that the performance incentives of the several electric companies were developed independently from one another and without any explicit guidance from either the Legislature or the DTE. To bring a more uniform approach to this matter, parties presented several proposals on this topic to the Department during the DTE 98-100 proceedings. In that docket, the DTE issued an Order wherein it adopted the DOER's proposal that the three-month Treasury bill (3MT-Bill) be used as the index for the performance incentive. The

Deleted: 3

Deleted: 3

Deleted: June 20, 2003

Deleted: 3

Deleted: 48

Deleted: 3

Deleted: 4

Deleted: I:\EEPlans-review\Final generic EEP apprvl ltr.3-9-04.doc

DOER had argued that this index represented an approximation of the market valuation of an appropriate level of return on low-risk investments for the energy efficiency administrators. At the time of the DTE proceeding, the DOER estimated that the 3MT-Bill typically averaged between 4 and 6%, an adequate level of return to motivate the companies to deliver high-quality energy efficiency services.

As we know, in late 2001 the 3MT-Bill dropped sharply due to the volatility of the market. From April to December 2001, the 3MT-Bill rate fell from 3.97 % to 1.72%, and then hovered at around 1.7% through September 2002. By December 2003, the yield on the 3MT dropped to .91% and stayed at or below that level through early 2004. During the past year the rates have enjoyed a substantial recovery. Through the middle of June 2005, the 3MT-Bill rate has roughly tripled, earning a 2.94% yield. The rate is steadily returning to the 4 to 6% range originally envisioned at the time the DTE issued its Order in 98-100. (See website of Federal Reserve Bank of St. Louis at: www.research.stlouisfed.org/fred2/series/WTB3MS). However, the DOER believes that the 3MT-Bill rate still remains at a level that does not sufficiently motivate the energy efficiency administrators. This occurrence threatens the Legislature's intent to provide high-quality energy efficiency programs to ratepayers. The lower yield level of the T-bill rate may yet impede the Company's full support for numerous aspects of the design and delivery of energy efficiency programs. Neither the state's energy efficiency goals nor the interests of utility customers would be well served by this outcome.

Proposal for 2005:

1. That the incentive calculation for the company set forth in Section 5 of the Guidelines be revised to substitute 5.00% for the average yield of the three-month United States Treasury bills issued in the most recent twelve months;
2. That the upper bound of the incentive level (exemplary level) be lowered to 110% of performance goals; and,
3. That the Company earn performance incentives once achievement reaches 75% of performance goals.

Section 1(2) of the Department's Guidelines enables Program Administrators to request alternative methods for use in reviewing energy efficiency programs. The DOER believes that the problems associated with the continuing low T-Bill index are sufficiently compelling that the requested modifications are justified. Consistent with these facts, the DOER recommends that the Department modify its performance incentive for 2005 with respect to NSTAR Electric Company according to the three changes described above. DOER believes this is a performance incentive rate that will motivate the Company to pursue the highest quality programs for ratepayers envisioned by the Legislature. This level of performance incentive is consistent with the rate of return the Division supported in DTE 98-100.

Deleted: However

Deleted: precipitous

Deleted: has

Deleted: please see Attachment 1

Deleted:

Deleted: T

Deleted: is a

Deleted: longer adequately

Deleted: s

Deleted: is a detracting factor for

Deleted: to

Deleted: the

Deleted: are

Deleted: 4

Deleted: (Please note that this is a change from the 70% threshold recommended for the Company in 2003. The Company has had one year in which to adapt to the new requirements of the performance incentive. Therefore, the DOER recommends that the threshold level that must be achieved before a company can earn any performance incentive be set at the level originally specified in the DTE guidelines). ¶

Deleted: 4

Deleted: . New Initiatives:¶

¶ As an appurtenance of our approval of the plan for consistency with statewide energy efficiency goals, the DOER recognizes certain specific initiatives undertaken by the Company worthy of note. ¶

¶ The Division acknowledges the commencement of a new residential lost opportunity program offered by all Program Administrators called "Energy Star Heating Ventilation and Air Conditioning." While realizing energy savings, this new offering intends both to motivate customers with incentives and to increase the skills of the contracting community. The PAs' ability to harmonize efforts and programs across service territories facilitates the development of a competitive market for energy efficiency products and advances market transformation. ¶

¶ The Division also takes note that all Program Administrators have worked collegially to improve the delivery mechanism and program design of the Residential Conservation Services (RCS) program through the RCS Network ... [2]

Deleted: I:\EEPlans-review\Final generic EEP apprvl ltr.3-9-04.doc

The Division is available to address any questions that the Department has regarding the DOER's findings with respect to the year 2005 NSTAR Electric Company energy efficiency plan and the associated performance incentive. Please let us know if you would like to discuss these matters.

Deleted: 4

Yours truly,

Steven I. Venezia
Deputy General Counsel

[Robert Harrold](#)
[Andrew Kaplan](#)
[David S. Rosenzweig](#)
[Roger Borghesani](#)
[Marc Breslow](#)
[Angela O'Connor](#)
[Jerrold Oppenheim](#)
[Joseph Rogers](#)

Deleted: Service List

Deleted: I:\EEPlans-review\Final generic EEP apprvl ltr.3-9-04.doc

Each year the DOER's energy efficiency staff works with the company and other non-utility parties in translating the statewide energy efficiency goals into the Energy Efficiency Plan program design and budgets for the coming year. During 2004-2005, the DOER, the PAs, and advisors to the non-utility parties (the Group) have emphasized [FIND OUT FROM LARRY WHAT GOALS & ENHANCEMENT ON WHICH THE GROUP CHOSE TO FOCUS IN 2005 identifying enhancements of energy efficiency plan updates and the annual reporting process. We selected two (2) goals around which we would focus our efforts to improve the program: 1) increased transparency and 2) improved administrative efficiency. THE FOLLOWING 3 PARAGRAPHS ARE LIKELY OUT. CONFIRM WITH LARRY.]

To effect the first goal, the Group made changes that will more consistently account for program costs. First, the modified detailed accounts that support the program goals in the first section are readily linked as program costs and benefits throughout the plan. Second, in the budget section, PAs establish budgets for each customer sector based on projected collections for this program year, the appropriate methodology for funding its low-income programs, and a reconciliation of actual collections, budgets and expenditure for the prior year. As a result of our reforms, we have reorganized the layout of the three customer sector tables that provide budgets for each sector program. The organization of these programs in the budget section now enjoys an identical format with the tables in the Program Description section of the plan.

To advance greater transparency, we now create linkage between program costs and benefits associated with each program. The Group created and the PAs adopted a common designation for programs. We believe that the net effect of this collective action is greater than the sum of any individual actions these parties may have taken because this cooperation has created significant additional benefits to ratepayers. Multiple benefits accrue as we can now more readily discern economic efficiencies and implement program design changes when individual programs lack sufficient benefit/ cost ratios. The term used to group these synergistic programs is Benefit-Cost Ratio Activity or BCR Activity. In Appendix A table 2, the PAs assign all costs of every program to the appropriate BCR Activity.

The DOER, NUP advisors and the PAs realized the goal of improving administrative efficiency in three (3) ways. First, the Group developed a common planning format. Anyone working with these plans will now see a similar narrative format and a common presentation of quantitative information. Second, the Group adopted a DOER proposal to organize the information in a database format. The database format will allow the DOER and others to more quickly and efficiently look at the quantitative information from both a year-to-year and a statewide perspective. Third, the DOER with Group support implemented a database reporting format for the annual reporting of energy efficiency activities. The benefits of using a database for program planning are tangibly promoted by employing identical data categories. The DOER believes that it will be able to provide more timely and comprehensive reporting of these energy efficiency activities to the Legislature and other interested parties by using these new database formats.

New Initiatives:

As an appurtenance of our approval of the plan for consistency with statewide energy efficiency goals, the DOER recognizes certain specific initiatives undertaken by the Company worthy of note.

The Division acknowledges the commencement of a new residential lost opportunity program offered by all Program Administrators called "Energy Star Heating Ventilation and Air Conditioning." While realizing energy savings, this new offering intends both to motivate customers with incentives and to increase the skills of the contracting community. The PAs' ability to harmonize efforts and programs across service territories facilitates the development of a competitive market for energy efficiency products and advances market transformation.

The Division also takes note that all Program Administrators have worked collegially to improve the delivery mechanism and program design of the Residential Conservation Services (RCS) program through the RCS Network. Electric PAs expend energy efficiency ratepayer funds to finance their RCS efforts. The DOER anticipates that this joint effort will maximize efficiencies and promote cost-effectiveness.

The DOER supports and draws the Department's attention to the following new Company initiatives:

In this year's plan NSTAR proposes to provide 0% financing in the Small Business Solutions program and 0% financing for municipal customers in the Business Solutions program.

In a concerted attempt to better gauge actual energy savings and to more accurately measure the cost effectiveness of certain measures, NSTAR's 2004 plan will now set program goals for energy and demand savings based on evaluations, not engineering estimates.

Consistent with our goal of ensuring equitable spending among customer classes, NSTAR pledges to carry over its current small fund balance in the C&I sector for C&I programs in its 2005 plan.

Notwithstanding our overall approval for the Company's 2004 plan, the Division may from time to time identify and judge certain programs as lacking adequate merit for inclusion in the plan. This year we have identified one such program. The DOER believes that the following item fails to make a compelling case for inclusion in the Company's plan.

The DOER does not support NSTAR's C&I Pilot and Research & Development proposal to spend energy efficiency funds on meters in the demand response program.

Recently, the New England – Independent System Operator (NE-ISO) made a request to have energy efficiency activities supplement its demand response program. This request was made at the Department's suggestion. The Division recognizes the potential value such an ancillary undertaking might have. However, NE-ISO asked only for marketing and educational assistance, citing that for certain programs, NE-ISO itself would subsidize the installation of meters. Where the NE-ISO has already pledged to underwrite meter installation, we believe that it would be duplicative to also allow energy efficiency ratepayer monies to be spent for this purpose. We do not perceive such an expenditure to be appropriate from a cost effectiveness perspective and we invite the Department to more closely examine the proposed pilot program to ascertain whether sufficient cost effectiveness exists.